

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Coleco Industries, Inc. :
: AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of Corporation :
Franchise Tax under Article 9-A of the Tax Law :
for the Years 1971 - 1974.

State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 31st day of July, 1981, he served the within notice of Decision by certified mail upon Coleco Industries, Inc., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Coleco Industries, Inc.
945 Asylum Ave.
Hartford, CT 06105

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
31st day of July, 1981.

Conrad R. Hegelund

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :
of :
Coleco Industries, Inc. :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of Corporation :
Franchise Tax under Article 9-A of the Tax Law :
for the Years 1971 - 1974.

State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 31st day of July, 1981, he served the within notice of Decision by certified mail upon Joseph M. Persinger the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Joseph M. Persinger
Milbank, Tweed, Hadley & McCloy
1 Chase Manhattan Plz.
New York, NY 10005

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
31st day of July, 1981.

Gracie A. Haglund

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

July 31, 1981

Coleco Industries, Inc.
945 Asylum Ave.
Hartford, CT 06105

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Deputy Commissioner and Counsel
Albany, New York 12227
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Joseph M. Persinger
Milbank, Tweed, Hadley & McCloy
1 Chase Manhattan Plz.
New York, NY 10005
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
COLECO INDUSTRIES, INC.	:	DECISION
	:	
for Redetermination of a Deficiency or	:	
for Refund of Franchise Tax on Business	:	
Corporations under Article 9-A of the	:	
Tax Law for the Years 1971 through 1974.	:	

Petitioner, Coleco Industries, Inc., 945 Asylum Avenue, Hartford, Connecticut 06105, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Article 9-A of the Tax Law for the years 1971 through 1974 (File Nos. 22909 and 28528).

A formal hearing was held before Doris Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 9, 1980 at 1:15 P.M. Petitioner appeared by Milbank, Tweed, Hadley & McCloy, Esqs. (Joseph M. Persinger, Esq., of counsel). The Audit Division appeared by Ralph J. Vecchio, Esq. (Irving Atkins, Esq., of counsel).

ISSUES

I. Whether petitioner is entitled to a default judgment in its favor for the year 1974, by reason of the Audit Division's failure to answer the separate petition for said year.

II. Whether petitioner Coleco Industries, Inc. and its subsidiary Coleco North Corporation should be permitted to file combined franchise tax returns for the years 1973 and 1974.

FINDINGS OF FACT

1. As a result of field audits conducted, the Audit Division issued to petitioner, Coleco Industries, Inc. ("Coleco"), four notices of deficiency

asserting franchise taxes due under Article 9-A of the Tax Law, scheduled as follows:

<u>DATE OF ISSUANCE</u>	<u>YEAR</u>	<u>DEFICIENCY</u>	<u>INTEREST</u>	<u>TOTAL</u>
7/25/75	1971	\$ 4,443.00	\$ 1,155.18	\$ 5,598.18
7/25/75	1972	4,126.00	1,031.50	5,157.50
7/25/75	1973	67,876.00	11,878.30	79,754.30
10/30/79	1974	54,969.00	21,607.00	76,576.00
		<u>\$131,414.00</u>	<u>\$35,671.98</u>	<u>\$167,085.98</u>

The deficiencies for 1971 and 1972 were asserted by reason of adjustments made to interest expense attributable to subsidiary capital, the business allocation percentage and the investment tax credit; the deficiency for 1973 was based upon the aforementioned adjustments as well as the Audit Division's refusal to allow petitioner to file a combined return with its subsidiary Coleco North Corporation; the deficiency for 1974 concerned only the disallowance of a combined return. At the formal hearing, petitioner, by its attorney, conceded the adjustments to interest expense attributable to subsidiary capital, the business allocation percentage and the investment tax credit.

2. Coleco filed a petition for redetermination of the asserted deficiencies for the years 1971 through 1973, which petition was deemed perfected by the State Tax Commission on April 3, 1979. The Audit Division served an answer thereto on or about June 6, 1979. On or about January 28, 1980, Coleco filed a petition for redetermination of the deficiency asserted for 1974. The Audit Division served no answer thereto. Both petitions were consolidated into the single within proceeding.

3. Coleco, a Connecticut corporation which began business in New York on January 2, 1962, is engaged in the manufacture and sale of recreational products: swimming pools, decks and filtration equipment; toys, including

toboggans, pool tables, doll carriages, pinball machines and knock-hockey games; and after 1971, snowmobiles.

4. On December 31, 1969, Coleco incorporated Coleco North Corporation ("Coleco North") under the laws of Connecticut; at all times since said date, Coleco North has been a wholly-owned subsidiary of Coleco.

5. During 1970 and 1971, Coleco North operated as a Western Hemisphere Trading Corporation; it purchased swimming pools and related products from Coleco at prices established by Coleco management, and sold the products to Coleco Canada, a Canadian subsidiary of Coleco, again at prices determined by Coleco. Coleco North did not perform any finishing of these products. All prices for the products, those paid to Coleco by Coleco North and those paid to Coleco North by Coleco Canada, were simply recorded on Coleco's intercompany books and records. Coleco North made no sales to any third parties (i.e., non-Coleco subsidiaries).

6. Coleco North had no separate officers, employees nor operating assets. Its officers and directors were those of the parent corporation. Its business functions were performed by Coleco employees and an intercompany charge made for such services. And, Coleco provided Coleco North with operating assets, insurance, and financial and accounting services.

7. During 1972, Coleco established a domestic international sales corporation under the name Coleco South. All transactions formerly conducted through Coleco North were thereafter conducted through Coleco South. During 1972 Coleco North made no sales.

8. In 1972, Coleco purchased Alouette Snowmobiles ("Alouette") from Bangor Punta Company and established it as a wholly-owned subsidiary of Coleco Canada. Alouette manufactured snowmobiles for distribution in Canada and

through Coleco, in the United States. Coleco sold the snowmobiles to various U.S. distributors unrelated to the Coleco family; Coleco itself did not sell any snowmobiles at retail. Various New York locations were used by Coleco for storage and distribution of snowmobiles and snowmobile parts. Coleco employees transacted the snowmobile business at these sites. In 1972, Coleco reported a slight loss on its snowmobile operations.

9. On January 1, 1973, Coleco transferred the domestic snowmobile distribution business to Coleco North. Coleco was seeking to expand the snowmobile business to New Hampshire, Michigan and Minnesota and did not wish to subject itself to taxation in those states. A further reason for the transfer of the snowmobile operation to Coleco North was to secure more accurate information about the snowmobile distribution business as a separate entity. The transfer was accomplished primarily by book entries.

10. During 1973 and 1974, Coleco North conducted no business other than snowmobile distribution. It purchased snowmobiles from Alouette and sold them to the same distributors to whom snowmobiles had been sold the previous year, plus some new customers in New Hampshire, Michigan and Minnesota. Prices paid by Coleco North to Alouette were set by Coleco management at a figure lower than prices charged Canadian distributors by Alouette. During 1973 and 1974 the snowmobile distribution business was conducted in essentially the same manner as it had been in 1972, except that it was conducted in the name Coleco North. Coleco provided to Coleco North legal, accounting and financial planning services and insurance, for which appropriate intercompany charges were made. Business functions were performed by Coleco North employees who were remunerated by Coleco.

11. By letter dated June 2, 1971, the State Tax Commission granted Coleco tentative permission to file its franchise tax report on a combined basis with Coleco North, commencing with the calendar year 1970. The Commission gave final approval after examining the report for that year.

12. By letter dated August 31, 1973, the Commission advised Coleco that, "Since Coleco North Corp. is now inactive, the combined report should be discontinued commencing with the calendar year 1973." On December 27, 1974, the Audit Division advised Coleco of certain adjustments made in its franchise tax returns for 1971 through 1973, including disallowance of the inclusion of Coleco North in the combined report for 1973. Coleco disagreed with these adjustments.

13. On July 25, 1975, the Audit Division issued to petitioner notices of deficiency, asserting additional franchise taxes due for 1971 through 1973. In determining the deficiency for 1973, the Division overruled Coleco's protest and determined that Coleco North would not be allowed to be included in a combined report with Coleco for that year.

14. By letter dated September 11, 1975, Coleco requested permission to include Coleco North in its combined report for 1974. A copy of this letter was also attached to Coleco's 1974 franchise tax return. By letter dated November 3, 1975, the Audit Division advised Coleco that, "No consideration can be given for 1974 as your request was not timely filed."

15. Coleco's combined franchise tax reports for 1973 and 1974 reflect that Coleco North incurred losses in those years of \$1,237,632.00 and \$1,275,887.00, respectively.

CONCLUSIONS OF LAW

A. That the Rules of Practice and Procedure before the State Tax Commission provide, in pertinent part:

"Where the Law Bureau fails to answer within the prescribed time, petitioner may make a motion to the Commission on notice to the Law Bureau, for a determination on default. Commission shall either grant that motion and issue a default decision or shall determine such other appropriate relief that it deems is warranted." 20 NYCRR 601.6(a)(4).

B. That petitioner's motion for a default decision, determining that there exists no deficiency in its franchise taxes for 1974, is hereby denied. The Audit Division's failure to serve an answer to petitioner's separate petition for that year did not so prejudice petitioner as to warrant such relief. The Division's answer to Coleco's petition for 1971 through 1973 addressed the principal issue raised by Coleco in its petition for 1974, i.e., whether petitioner and its subsidiary Coleco North should be permitted to file franchise tax reports on a combined basis.

C. That subdivision 4 of section 211 of the Tax Law authorizes the State Tax Commission, in its discretion, to require or permit a parent corporation and its wholly-owned subsidiary to make a report on a combined basis. However, no combined report covering a foreign corporation not doing business in New York may be required, unless the Commission deems such a report necessary because of intercompany transactions or some agreement, understanding, arrangement or transaction which distorts income or capital, in order to properly reflect tax liabilities.

D. That during the periods at issue, the Tax Commission provided, by regulation, that in determining whether the tax would be computed on a combined basis, it would consider various factors, including the following:

- (1) Whether the corporations were engaged in the same or related lines of business;
- (2) Whether any of the corporations were in substance merely departments of a unitary business conducted by the entire group;
- (3) Whether the products of any of the corporations were sold to or used by any of the other corporations;
- (4) Whether any of the corporations performed services for, or loaned money to, or otherwise financed or assisted in the operations of any of the other corporations;
- (5) Whether there were other substantial intercompany transactions among the constituent corporations.
Former 20 NYCRR 5.28(b).

The essential elements of these factors have been carried over into the current regulations which were effective for taxable years beginning on or after January 1, 1976, and which provide in pertinent part:

"In deciding whether to permit or require combined reports the following two (2) broad factors must be met:

- (1) the corporations are in substance parts of a unitary business conducted by the entire group of corporations, and
- (2) there are substantial intercorporate transactions among the corporations." 20 NYCRR 6-2.3(a)

The mandatory language of the current regulations takes cognizance of those elements which the Tax Commission has consistently deemed to be the key factors in determining whether combination should be permitted or required, i.e., the unitary nature of the business conducted by the corporations, and whether there were substantial intercorporate transactions among the corporations. Matter of Annel Holding Corp. et al., State Tax Commission, August 2, 1973, determination confirmed, Annel Holding Corp. v. Procaccino, 77 Misc. 2d 886 (Sup. Ct. Albany Co. 1974); Matter of N. K. Winston Corp. et al., State Tax Commission, August 21, 1974; Matter of Alpha Computer Service Corporation et al., State Tax Commission, September 28, 1979; Matter of Montauk Improvement, Inc. and

Montauk Country Club, Inc., State Tax Commission, September 28, 1979. These factors must be given particular emphasis, although all five factors of former 20 NYCRR 5.28(b) must be considered.

E. That the facts as recited supra reveal that during 1973 and 1974 petitioner provided to its subsidiary Coleco North legal services, accounting and financial planning services, and insurance; Coleco management fixed the prices at which Coleco North purchased snowmobiles from Alouette; Coleco North employees were compensated by Coleco; Coleco North's officers were those of the parent; and parent and subsidiary were engaged in related lines of business -- recreational products.

The third factor enumerated in the regulation was totally absent. The administrative services and financial assistance rendered by the parent corporation were relevant to the fourth factor; no "other substantial intercorporate transactions" were shown. Petitioner has failed to satisfy two of the five criteria.

F. That for 1973 and 1974 petitioner may not file on a combined basis with Coleco North.

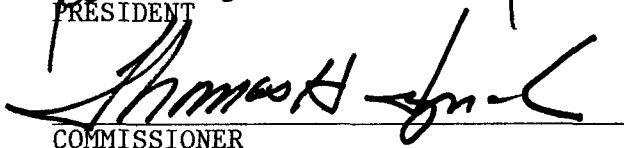
G. That the petitions of Coleco Industries, Inc. are hereby denied and the notices of deficiency issued for the years 1971 through 1974 are sustained in full.

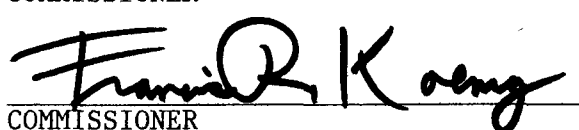
DATED: Albany, New York

JUL 31 1981

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER